

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

RICHARD B. EDMONDS,

Plaintiff,

v.

MARK H. GETTY, et al.,

Defendants.

CASE NO. C07-317JLR

ORDER

Richard B. Edmonds filed this derivative action on behalf of nominal Defendant Getty Images, Inc. (“Getty Images”) against certain members of Getty Images’ Board of Directors (the “Board”) and certain executive officers. Mr. Edmonds alleges violations of § 10(b) and Rule 10b-5 of the Securities and Exchange Act; § 14(a) of the Securities Exchange Act; and § 20(a) of the Securities Exchange Act. Mr. Edmonds also alleges claims for breach of fiduciary duty and/or aiding and abetting; unjust enrichment; constructive fraud; corporate waste; and insider selling and misappropriation of information. Nominal Defendant Getty Images filed a motion to dismiss for failure to make a litigation demand under Federal Rule of Civil Procedure 23.1 (Dkt. # 14). Mr. Edmonds then filed an amended complaint (Dkt. # 16). The court allowed Mr. Edmonds

1 to file a Surreply (Dkt. # 22). Having considered the papers filed in support of and in
2 opposition to the motion and having heard argument from counsel, for the reasons that
3 follow, the court DENIES the motion. The court finds that demand was futile because
4 there is reason to doubt that a majority of the directors at the time the complaint was filed
5 could have properly exercised their independent and disinterested business judgment in
6 responding to a demand.
7

8 **I. BACKGROUND**

9 On March 18, 2006, the *Wall Street Journal* published an article entitled “The
10 Perfect Payday” which suggested that backdating may have been rampant throughout the
11 1990s up until 2002 when the Sarbanes-Oxley corporate reform act was enacted.
12 Spoonemore Decl. (Dkt. # 19) Ex. A. Backdating occurs when a stock option’s grant date
13 is altered to an earlier date with a lower, more favorable price to the recipient. The article
14 analyzed grants at several companies and determined that the odds of several grants all
15 occurring on days in which the stock prices were very low were worse than winning the
16 Powerball lottery. *Id.* The Securities and Exchange Commission (“SEC”) began
17 investigating several companies to determine whether the patterns uncovered were simply
18 due to chance or whether the grants had been backdated. The article spawned litigation
19 alleging backdating of stock options against some of the companies named in the article
20 as well as others that were not named, like Getty Images, in courts throughout the
21 country.
22

23 On November 9, 2006, in response to an informal inquiry by the SEC, Getty
24 Images announced that it had undertaken an internal investigation of stock option grant
25 practices. Spoonemore Decl. Ex. C. A Special Committee was formed and tasked with
26 investigating Getty Images’ stock option grant practices and related accounting for stock
27 option grants. *Id.* The Committee included two independent members of the Board, Alan
28

1 G. Spoon and Michael A. Stein, who were assisted by outside counsel, Orrick, Herrington
2 & Sutcliffe. Spoonmore Decl. Ex. E.

3 On January 29, 2007, a case alleging improper accounting and disclosure of option
4 grants entitled *Lopez v. Mark H. Getty, et al.*, was filed in King County, Washington.
5 Mot. at 4. It is Getty Images' view that the claims in that case are "substantially similar"
6 to the claims in this case. *Id.* On February 14, 2007, the Board converted the Special
7 Committee into a Litigation Committee. Spoonmore Decl. Ex. J. Mr. Spoon and Mr.
8 Stein continued on as members of the Committee. *Id.* The Special Litigation Committee
9 was given the "power and authority to investigate, analyze and evaluate the derivative
10 claims raised in the [*Lopez*] Litigation, to consider and determine whether prosecution of
11 the derivative claims in the [*Lopez*] Litigation is in the best interests of the Company and
12 its stockholders, and to determine the actions, if any, the Corporation should take with
13 respect to the derivative claims in the [*Lopez*] Litigation" Spoonmore Decl. Ex. J.

14
15 On March 2, 2007, Mr. Edmonds filed this lawsuit (Dkt. # 1).

16
17 On April 16, 2007, a press release was issued that detailed the conclusions of the
18 Committee. Spoonmore Decl. Ex. E. The Committee reviewed equity compensation
19 grant practices and awards made by Getty Images between July 14, 1994 and November
20 1, 2006 which covered 8,164 grants made on 465 occasions. *Id.* The Committee
21 "concluded that the evidence obtained and reviewed in its investigation did not establish
22 any intentional wrongdoing by current employees, officers or directors of the Company . .
23 . ." *Id.* However, the Committee

24
25 determined that incorrect measurement dates for certain equity compensation
26 awards made during the Relevant Period were used for financial accounting
27 purposes and, as a result, the Company will restate its prior financial
28 statements to correct the accounting for those awards. The use of incorrect
measurement dates resulted from a number of reasons, including delays in the
approval of awards, the absence of definitive documentation and modifications
of previously awarded grants. The Special Committee also identified certain
awards for which grant dates were selected retroactively. However, the

1 Special Committee has concluded that the evidence does not establish that
2 there was any intentional wrongdoing in connection with those awards.
3 Nearly all of the grants for which the measurement dates are being changed
4 (approximately 98% of the grants) were awarded in 2001 and earlier years.
5 The Company anticipates that the restatement will involve total pre-tax, non-
6 cash stock-based compensation expense of approximately \$28 million to \$32
7 million, of which approximately 95% will be expensed in 2002 and earlier
8 years. Because these estimates are preliminary and we have not quantified all
9 of the tax impacts, the net after tax amounts to be restated have not yet been
10 determined by the Company.

11 *Id.* The Committee determined that it was necessary to revise the measurement dates for
12 3,700 of the grants that were made on approximately 130 occasions. Spoonemore Decl.
13 Ex. E. It noted that over half of the grants for which the measurement dates were being
14 revised related to an all employee award in February 2000 given to all employees below
15 the vice president level. *Id.*

16 The Special Committee recommended, and the Board adopted, the following
17 changes “to improve the Company’s equity compensation grant practices.” *Id.* The
18 recommendations included adding two additional independent directors to the Board;
19 changing the membership of the audit and compensation committees; discontinuation of
20 the equity compensation committee; enhancements to the oversight of Getty Images’
21 corporate governance practices; charging senior management with ensuring that equity
22 compensation policies and processes are appropriate and provide effective controls and
23 that Getty Images’ accounting for equity compensation is appropriate; moving certain of
24 Getty Images’ equity compensation administrative processes and functions from its
25 human resources organization to the finance organization; and adopting a new equity
26 compensation grant policy. Spoonemore Decl. Ex. E.

27 Getty Images points to one of the “significant” effects of the Committee’s work as
28 being its decision to restate certain financial statements.

On June 13, 2007, Getty Images filed: (a) its Form 10-K for the fiscal year
ending December 31, 2006; and (b) amended Quarterly Reports on Form 10-
Q/A for the quarters ending March 31, 2006 and June 30, 2006. These filings

1 served to restate: (i) the consolidated financial statements for the fiscal years
2 ending December 31, 2005 and 2004; (ii) selected consolidated financial data
3 for fiscal years ending December 31, 2005, 2004, 2003, and 2002; and (iii)
4 unaudited quarterly financial data for each quarter in its fiscal year ending
5 December 31, 2005 and the first and second quarters of fiscal year 2006.

6 Mot. at 7; Spoonemore Decl. Exs. F, G.

7 II. ANALYSIS

8 A shareholder seeking to bring a derivative action on behalf of a corporation must
9 first demand action from the corporation's directors or plead with particularity the
10 reasons why such demand would have been futile. *See* Fed. R. Civ. P. 23.1. The federal
11 rules however do not establish the circumstances under which demand would be futile.
12 *In re Silicon Graphics Inc.*, 183 F.3d 970, 989-90 (9th Cir. 1999). Courts look to the law
13 of the state of incorporation to determine whether demand in a particular case would have
14 been futile. *Id.* at 990. Getty Images is a Delaware corporation and so the law of
15 Delaware applies.

16 "A cardinal precept of the General Corporation Law of the State of Delaware is
17 that directors, rather than shareholders, manage the business and affairs of the
18 corporation." *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984) *overruled on other*
19 *grounds by Brehm v. Eisner*, 746 A.2d 244, 254 (Del. 2000). Delaware has two tests for
20 determining whether demand is futile. The first, the "*Aronson* test," excuses a failure to
21 make a demand where a plaintiff raises a reason to doubt that: (1) the directors are
22 disinterested and independent or (2) the challenged transaction was otherwise the product
23 of the directors' valid exercise of business judgment. *Id.* at 814. "The essential predicate
24 for the *Aronson* test is the fact that a *decision* of the board of directors is being challenged
25 in the derivative suit." *Rales v. Blasband*, 634 A.2d 927, 933 (Del. 1993). The Delaware
26 Supreme Court instructs that where the board that would consider the demand did not
27 make the decision being challenged, that courts should apply a different test, the "*Rales*
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1 test.” *Id.* at 933-34. Under *Rales*, “a court must determine whether or not the
2 particularized factual allegations of a derivative stockholder complaint create a reasonable
3 doubt that, as of the time the complaint is filed, the board of directors could have properly
4 exercised its independent and disinterested business judgment in responding to a demand.
5 If the derivative plaintiff satisfies this burden, then demand will be excused as futile.” *Id.*
6 at 934. Here, where the challenged transactions were not made by the Board, or even
7 half of its members, *Rales* applies.

8
9 At the time the complaint was served, the Board consisted of the following
10 directors: James N. Bailey, Andrew S. Garb, Mark H. Getty, Jonathan D. Klein, Alan G.
11 Spoon, Christopher H. Sporborg and Michael A. Stein. Am. Compl. ¶¶ 23-37. In order
12 to find that demand is excused in this case, the court would need to find that Mr.
13 Edmonds’ allegations raise a reasonable doubt that at least four of these directors, a
14 majority of the Board, could have properly exercised their independent and disinterested
15 business judgment in evaluating a demand.

16
17 **A. Mr. Spoon and Mr. Stein**

18 Mr. Edmonds does not make any allegations that Mr. Spoon and Mr. Stein were
19 not disinterested at the time the complaint was filed. The court finds that these directors
20 were disinterested at the time the complaint was filed.

21 **B. Mr. Getty, Mr. Klein, and Mr. Sporborg**

22 Mr. Edmonds alleges that Mr. Getty, Mr. Klein, and Mr. Sporborg received
23 backdated stock options. Am. Compl. ¶¶ 25, 29, 33. At the pleading stage the question is
24 whether the plaintiff has alleged circumstances from which it may be reasonably inferred
25 that backdating as opposed to an innocent bookkeeping error occurred. *In re CNET*
26 *Networks, Inc.*, 483 F. Supp. 2d 947, 956 (N.D. Cal. 2007). “A director is considered
27 interested where he or she will receive a personal financial benefit from a transaction that
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1 is not equally shared by the stockholders. Directorial interest also exists where a
2 corporate decision will have a materially detrimental impact on a director, but not on the
3 corporation and the stockholders.” *Rales*, 634 A.2d at 936. “[D]irectors receiving
4 backdated stock options receive a benefit *not* shared by stockholders. When purchasing
5 the company’s stock, the shareholders do not have the benefit of reaching back in time to
6 buy their shares at [a] low-price point.” *In re Zoran Corp.*, 511 F. Supp. 2d 986, 1002-03
7 (N.D. Cal. 2007) (applying Delaware law). “Directors who are sued have a disabling
8 interest for pre-suit demand purposes when the potential for liability is not a mere threat
9 but instead may rise to a substantial likelihood.” *Ryan v. Gifford*, 918 A.2d 341, 355
10 (Del. Ch. 2007) (quotation marks and citation omitted). Allegations that a board member
11 accepted backdated options raise a reason to doubt the disinterestedness of the board and
12 to suggest that they were incapable of impartially considering a demand. *Id.* at 356; *see*
13 *also Zoran*, 511 F. Supp. 2d at 1003 (N.D. Cal. 2007) (“[I]f plaintiffs can plead with
14 particularity that the directors received backdated grants, those directors will be
15 considered interested.”)

18 Mr. Edmonds alleges that 21 out of 25 discretionary grant dates from April 1999
19 to February 2002 were backdated. Am. Compl. ¶ 114. Eight grants were made at or near
20 the lowest price of the fiscal year and fourteen were made at or near the lowest price of
21 the fiscal quarter. *Id.* It is alleged that Mr. Getty received backdated options on October
22 22, 1999 (15,000 options at an exercise price of \$19.07), April 28, 2000 (400,000 options
23 at an exercise price of \$30.32), May 24, 2000 (400,000 options at an exercise price of
24 \$28.63), March 30, 2001 (50,000 options at an exercise price of \$16.85), and October 15,
25 2001 (50,000 options at an exercise price of \$12.41); Mr. Klein received backdated
26 options on October 22, 1999 (15,000 options at an exercise price of \$19.07), April 28,
27 2000 (400,000 options at an exercise price of \$30.32), May 24, 2000 (400,000 options at

1 an exercise price of \$28.63), March 30, 2001 (50,000 options at an exercise price of
2 \$16.85), May 7, 2001 (232,000 options at an exercise price of \$25.43), June 26, 2001
3 (170,000 options at an exercise price of \$25.43), and October 15, 2001 (50,000 options at
4 an exercise price of \$12.41); and Mr. Sporborg received a backdated option grant on July
5 23, 2001 (8,333 options at an exercise price of \$15.80). Am. Compl. ¶¶ 25, 30, 33.

6
7 In *Ryan*, 918 A.2d at 354, a Delaware court found that the allegations in the
8 complaint raised a reasonable doubt as to whether the challenged transactions were a
9 valid exercise of business judgment. The *Ryan* court first looked to the fact that “the
10 terms of the stock option plans *required* that ‘[t]he exercise price of each option shall be
11 not less than one hundred percent (100%) of the fair market value of the stock subject to
12 the option on the date the option is granted.’ The board had no discretion to contravene
13 the terms of the stock option plans. Altering the actual date of the grant so as to affect the
14 exercise price contravenes the plan.” *Id.* Second, the court examined plaintiff’s
15 allegations that every challenged option occurred during the lowest market price of the
16 month or year in which it was granted. *Id.* The court noted that plaintiff further
17 supported his allegations with “empirical evidence” that backdating occurred.
18 Specifically, plaintiff used an analysis developed by Merrill Lynch¹ to determine that the
19 average annualized return of 243% on option grants to management was nearly ten times
20 higher than the 29% annualized market returns in the same period. *Id.* The court found
21 that the “appearance of impropriety grows even more when one considers the fact that the
22 board granted options, not at set or designated times, but by a sporadic method.” *Id.* at
23 355. The court stated that, “[t]his timing by my judgment and by support of empirical
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27 ¹The Merrill Lynch analysis examines the 20-day performance of each option grant
28 reported in a company’s proxy statements during the relevant period. Am. Compl. at ¶ 183.
Under the analysis a calculation of the annualized return of the option grants at 20 days after the
grant is made, which is then compared with the company’s overall annual return. *Id.*

1 data, seems too fortuitous to be mere coincidence.” *Id* at 354-55. The court concluded:
2 “Plaintiff here points to specific grants, specific language in option plans, specific public
3 disclosures, and supporting empirical analysis to allege knowing and purposeful
4 violations of shareholder plans and intentionally fraudulent public disclosures. Such
5 facts, in my opinion, provide sufficient particularity in the pleading to survive a motion to
6 dismiss for failure to make demand pursuant to Rule 23.1.” *Id.* at 355. The court also
7 determined that if the case were analyzed under the *Rales* rather than the *Aronson* test
8 that demand would have still been futile. *Id.*

10 Mr. Edmonds models his complaint after the complaint in *Ryan*. Mr. Edmonds
11 alleges that: “Under the 1998 Plan, the exercise price of options must be ‘no less than
12 100% of the Fair Market Value per share on the date of the grant,’ where fair market
13 value is defined as ‘the average of the high and low prices of the Common Stock on such
14 exchange or such quotation on the date set for valuation.’” Am. Compl. ¶ 112. In other
15 words, if backdated options were granted it would have been against the plan.

17 Mr. Edmonds next alleges that “21 out of 25 discretionary grant dates from April
18 1999 to February 2002 were backdated, and the pattern of grants was more than
19 fortuitous – eight were made at or near the lowest price of the fiscal year, and fourteen
20 were made at or near the lowest price of the fiscal quarter.” Am. Compl. ¶ 114. For each
21 of the challenged grants, Mr. Edmonds alleges the date on which the grant was awarded,
22 to whom the options were awarded, and the number of options awarded. *See, e.g.*, Am.
23 Compl. ¶¶ 125-128. Mr. Edmonds also provides graphs charting the grant date against
24 the price for each grant for both the quarter in which the grant was issued and the fiscal
25 year in which it was issued. *See, e.g.*, Am. Compl. ¶ 128. While this evidence is not as
26 compelling as the evidence in *Ryan* (that each grant was at the lowest price of the month
27 or year in which it was granted) it does show that grants were made when stock prices

1 were low. As the court in *CNET* noted in response to an argument by defendants that not
2 all grants fell on the lowest possible price of the relevant period: “This argument is like
3 giving a bank robber credit for leaving some cash in the vault. Perhaps they did not want
4 to make it too obvious by being too greedy. The simple fact that there were days close in
5 time where the stock closed at an even lower price is not sufficient to defeat the facts
6 pleaded by plaintiffs.” 483 F. Supp. 2d at 961.

7
8 Using the analytical framework developed by Merrill Lynch, Mr. Edmonds alleges
9 that for the options granted in 1999, the average 20-day return is 25.57% or 460.31%
10 annualized as compared to a 176.26% annualized return to investors. Am. Compl. ¶ 186.
11 Mr. Edmonds alleges that applying the Merrill Lynch analysis for the option grants in
12 2000, the average 20-day return is 10.22% or 183.91% annualized as compared to a
13 -34.03% annualized return to investors in 2000. Am. Compl. ¶ 187. For the grants in
14 2001, the average 20-day return is 17.04% or 306.76% annualized, as compared to a
15 -26.37% annualized return to investors in 2001. Am. Compl. ¶ 188. Over the three year
16 period the average annualized return to management on the option grants identified was
17 317% as compared to a 38.62% average annualized return to investors. Am. Compl. ¶
18 189.

19
20 Finally, Mr. Edmonds labels these grants as “discretionary” leading to the
21 conclusion that they were not part of any overall plan setting forth at what time options
22 were to be given. *See* Am. Compl. ¶ 114. At oral argument counsel for Getty Images
23 stated that these grants were not, in fact, issued pursuant to any overall plan.

24
25 Getty Images claims that Mr. Edmonds has failed to allege circumstances from
26 which it may be reasonably inferred that backdating as opposed to innocent bookkeeping
27 errors occurred. First, it attacks Mr. Edmond’s use of the Merrill Lynch analysis. Getty
28 Images points out that Merrill Lynch itself did not conclude that any of the companies its

1 report examined actually backdated options. Reply at 7. In doing so, Getty Images
2 stretches what the report actually says. In the report, Merrill Lynch merely emphasized
3 that they were not taking any position on whether companies actually backdated options.
4 Supp. Spoonemore Decl. (Dkt. # 19) Ex. N. Additionally, at the pleading stage, the
5 plaintiff need not prove that backdating occurred but rather must only allege
6 circumstances from which it may be reasonably inferred that backdating as opposed to an
7 innocent bookkeeping error occurred. *See CNET*, 483 F. Supp. 2d at 956.
8

9 Getty Images next argues that companies are more likely to issue grants when they
10 perceive their stock to be undervalued. Reply at 8. Getty Images provides no evidence
11 that this is the case here. Getty Images also asserts that many investors take the issuance
12 of grants as a signal from the company that it believes its shares are undervalued. *Id.*
13 Again, it is not clear from the papers filed by Getty Images whether this may have been
14 the case here.
15

16 Getty Images also claims that the reliability of a 20-day analysis is suspect if the
17 stock is volatile. *Id.* It argues, citing *In re PMC-Sierra, Inc.*, No. 06-05330, 2007 WL
18 2427980, *3 (N.D. Cal. Aug. 22, 2007), that there is nothing magical about a 20-day
19 window. Getty Images attached an Appendix to its motion showing that at least, for some
20 periods its stock price was subject to large variations over 20, 30 and 40-day periods.
21 Mot. at Appendix B. It argues that an examination of the stock price over a 40-day
22 period demonstrates that no pattern of backdating exists. Reply at 10. Getty Images fails
23 to explain in its papers why a 40-day period is better than a 20-day period or why its
24 analysis is superior to or more reliable than the analysis employed by Mr. Edmonds.
25 And, at oral argument, counsel for Getty Images conceded that the selection of a 40-day
26 window was no better than the 20-day period. It also complains that the alleged pattern is
27 driven by two grants made in a single month that resulted in a 1,500% gain. Reply at 9.
28

1 Again, Getty Images fails to clearly and cogently explain or demonstrate how this
2 adversely affected the analysis. The court is not inclined to adopt Getty Images' analysis
3 without an explanation of why it is superior to or more reliable than the analysis
4 presented by Mr. Edmonds.

5 Lastly, Getty Images argues that external events *may* have a dramatic effect on a
6 company's annualized returns. Reply at 9. Specifically, Getty Images points to the
7 bursting of the Internet bubble and the events of September 11, 2001. *Id.* It states that
8 grants awarded to officers and directors in early 2001 had significantly higher returns
9 than the annualized returns to investors for that year. *Id.* Getty Images again fails to
10 explain why this makes Mr. Edmonds' use of the Merrill Lynch analysis here improper.

11 Getty Images also cites several cases, some of which are un-published and none of
12 which are binding on this court, in which it was found that demand was not futile. These
13 cases are all distinguishable on their facts. In *CNET*, the court refused to find demand
14 excused where plaintiffs failed to plead facts about the full universe of options (as
15 opposed to only those options granted at a low-point in price), when the options were
16 granted, under what circumstances the options were granted or any facts regarding the
17 board's role in granting the options. 483 F. Supp. 2d at 958. In *In re Verisign, Inc.*, No.
18 06-4165, 2007 WL 2705221, *15 (N.D. Cal. September 14, 2007) the court would not
19 excuse demand where the complaint contained "no particularized allegations stating
20 which director or directors approved which grant, or when such grant was approved and
21 how it was backdated-and no allegations showing how or why a particular director would
22 know that the options were backdated." The court also noted that "while it is not clear
23 from the [complaint] whether the Board approved the option grants, it appears that a
24 majority of the current members of the Board were not directors at the time of the alleged
25 backdating." *Id.* The court in *Desimore v. Barrows*, 924 A.2d 908, 914, 920-21 (Del.

1 Ch. 2007) declined to find demand excused where, for at least some of the challenged
2 options, there was no requirement that grants be priced at fair market value on the date of
3 the grant and the complaint was devoid of any factual allegations on the key issues of
4 who approved the employee grants and whether any of the directors knew that options
5 were being backdated. In *In re Openwave Sys. Inc.*, 503 F. Supp. 2d 1341, 1351 (N.D.
6 Cal. 2007), the court found that plaintiffs failed to “compare the average 20 day return on
7 all reported stock option grants during the relevant period to the average 20 day return on
8 Openwave stock during the period.” The court concluded that the plaintiffs’ allegations
9 and statistical analyses were insufficient to allow a reasonable inference of backdating.
10 *Id.* In *In re Linear Tech. Corp.*, No. 06-3290, 2006 WL 3533024, *3 (N.D. Cal Dec. 7,
11 2006), the court found that demand was not futile stating: “[P]laintiffs provide no facts
12 as to how often and at what times the Committee Defendants have granted stock options
13 in the past, no ‘pattern,’ let alone a ‘striking’ one, is apparent. Moreover, plaintiffs have
14 failed to allege facts as to how the asserted backdating affected the price the Officer
15 Defendants ultimately paid for the stock, and, as a consequence, have failed to
16 demonstrate, let alone with particularity, the Committee Directors’ approval of the
17 options harmed Linear.” In *PMC-Sierra*, 2007 WL 2427980 at *4-6 the court found
18 demand was not excused where plaintiff did not present an adequate statistical analysis to
19 negate the prospect that the favorable grant dates were merely fortuitous, did not examine
20 all options granted during the relevant period and failed to allege other facts raising an
21 inference that backdating occurred. None of these deficiencies are present here.

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25 The court does not find Getty Images’ arguments persuasive; instead, it adopts the
26 reasoning in *Ryan* and finds that Mr. Edmonds alleged facts sufficient to reasonably infer
27 that backdating rather than innocent bookkeeping errors occurred. The court also finds
28 that Mr. Edmonds’ allegations that Board members, Mr. Getty, Mr. Klein, and Mr.

1 Sporborg accepted backdated options coupled with the allegations raising a reasonable
2 inference that backdating occurred are sufficient to raise a reason to doubt these directors'
3 disinterestedness and to suggest that they would have been incapable of impartially
4 considering a demand. *See Ryan*, 918 A.2d at 356; *see also Zoran Corp.*, 511 F. Supp.
5 2d at 1003 (“[I]f plaintiffs can plead with particularity that the directors received
6 backdated grants, those directors will be considered interested.”)

7
8 **C. Mr. Bailey, Mr. Garb, and Mr. Sporborg**

9 “[I]ntentional violation of a shareholder approved stock option plan, coupled with
10 fraudulent disclosures regarding the directors’ purported compliance with that plan,
11 constitute conduct that is disloyal to the corporation and is therefore an act in bad faith.”
12 *Ryan*, 918 A.2d at 358. “A director who approves the backdating of options faces at the
13 very *least* a substantial likelihood of liability, if only because it is difficult to conceive of
14 a context in which a director may simultaneously lie to his shareholders . . . and yet
15 satisfy his duty of loyalty. Backdating options qualifies as one of those ‘rare cases [in
16 which] a transaction may be so egregious on its face that board approval cannot meet the
17 test of business judgment, and a substantial likelihood of director liability therefore
18 exists.” *Id.* at 355-56 (citing *Aronson*, 473 A.2d at 815). And as *Ryan* teaches
19 “[d]irectors who are sued have a disabling interest for pre-suit demand purposes when the
20 potential for liability is not a mere threat but instead may rise to a substantial likelihood.”
21 *Id.* at 355 (citation and quotation marks omitted).

22
23 Mr. Edmonds alleges that Mr. Bailey and Mr. Sporborg were members of the
24 compensation committee from 1998 through 2006 and that Mr. Garb was the chairman of
25 the compensation committee from 1998 through 2006. Am. Compl. ¶ 98. Mr. Edmonds
26 also alleges that during the relevant time period Mr. Bailey, Mr. Garb, and Mr. Sporborg
27 had the authority to administer the stock option plans and grant stock options thereunder;
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1 were aware that the stock option plans required that stock options be granted at not less
2 than fair market value on the date of the grant; that they approved the challenged grants
3 on a date after the reported grant date and knowingly used hindsight to select a favorable
4 date; that they knew that backdating grants to a date with a lower price violated the 1998
5 stock plan; and that their backdating caused each of Getty Images' Form 10-K and Form
6 10-Q for the relevant period to materially understate Getty Images' compensation
7 expense and materially overstate Getty Images' net income or materially understate its net
8 loss. *See, e.g.*, Am. Compl. ¶¶ 125-127, 201. As in *Ryan*, Mr. Edmonds has alleged that:
9 (1) the compensation committee had the authority to authorize the options² at issue and
10 ensure that they were issued at fair market value as of the date of the grant; (2) the
11 committee did not comply with the stock option plan by granting backdated stock options;
12 and (3) the compensation committee then falsely represented to shareholders that the
13 company was complying with the plan by preparing and signing financial and proxy
14 statements. This is enough at the pleading stage to demonstrate that the members of the
15 compensation committee face a substantial likelihood of liability.
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19 ²Mr. Edmonds acknowledges that the compensation committee was permitted to
20 delegate its authority under the 1998 plan but its authority was limited as follows:

21 The Committee may, but need not, from time to time delegate some or all of its
22 authority under the Plan to an Administrator consisting of one or more members of
23 the Committee or of one or more officers of the Company; provided, however, that
24 the Committee may not delegate its authority (i) to grant Awards to Eligible
25 Individuals (A) who are subject on the date of the grant to the reporting rules under
26 Section 16(a) of the Exchange Act, (B) who are Section 162(m) Participants or (C)
27 who are officers of the Company who are delegated authority by the Committee
28 hereunder, or (ii) under Sections 3(b) and 17 of the Plan . . . Nothing in the Plan
shall be construed as obligating the Committee to delegate authority to an
Administrator, and the Committee may at any time rescind the authority delegated
to an Administrator appointed hereunder or appoint a new Administrator.

Am. Compl. ¶ 111. Getty Images has not argued that the grants at issue were made by
individuals other than those on the compensation committee.

1 Getty Images argues that Mr. Edmonds' allegations are mere conclusions and not
2 specific facts. It claims: "No facts are pled tending to show that 'knowing hindsight' was
3 used to select a 'favorable' date." Reply at 3. However, at the pleading stage it would be
4 nearly impossible to plead "precisely what defendants knew about backdating . . . and
5 exactly when they knew it." *CNET*, 483 F. Supp. 2d at 966.

6 Citing *CNET*, 482 F. Supp. 2d at 962-963 Getty Images argues that where there is
7 an innocent explanation offered in addition to the more nefarious explanation that the
8 court must accept the innocent explanation in the absence of other specific facts
9 indicating fraud. Reply at 4. The court does not read *CNET* to suggest this proposition;
10 rather, the court in *CNET* discussed the situation where a plaintiff sought to rely solely on
11 the fact that the defendant corporation repriced its stock after an investigation, to argue
12 that each instance of repricing was an admission of fraud. *Id.* This is not the case here.

13 Getty Images also cites *Desimone* which dismissed a complaint for failure to make
14 a demand because the plaintiff failed to plead "facts creating a rational inference that the
15 directors knowingly approved backdated grants of options, realizing that the corporation
16 would deceptively account for them to investors and regulatory authorities" 924
17 A.2d at 915. Mr. Edmonds has made such allegations here. *See e.g.*, Am. Compl. ¶¶
18 125-128, 201, 202.

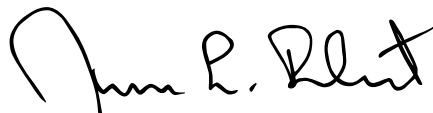
19 The court is not persuaded by Getty Images' arguments. The court finds that the
20 allegations in the complaint, if true, demonstrate that the members of the compensation
21 committee face a substantial likelihood of liability. Because directors who are sued have
22 a disabling interest for pre-suit demand purposes when the potential for liability is not a
23 mere threat but instead rises to a substantial likelihood, the court finds that the allegations
24 in the complaint have raised a reasonable doubt that, as of the time the complaint was
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1 filed, Mr. Bailey, Mr. Garb, and Mr. Spborg could have properly exercised their
2 independent and disinterested business judgment in responding to a demand.

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4 **III. CONCLUSION**

5 The court finds that Mr. Edmonds has pleaded particularized facts that create a
6 reasonable doubt that, as of the time the complaint was filed, the Board could have
7 properly exercised its independent and disinterested business judgment in responding to a
8 demand. For the foregoing reasons the court DENIES Getty Images' motion to dismiss
9 for failure to make a litigation demand (Dkt. # 14).

10 DATED this 5th day of December, 2007.

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14 JAMES L. ROBART
15 United States District Judge
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